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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of California American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its Monterey District to increase revenues by \$9,456,100 or 32.88% in the year 2006; \$1,894,100 or 4.95% in the year 2007; and \$1,574,600 or 3.92% in the year 2008; and for an order authorizing sixteen Special Requests with revenue requirements of \$3,815,900 in the year 2006, \$5,622,300 in the year 2007, and \$8,720,500 in the year 2008; the total increase in rates for water service combined with the sixteen Special Requests could increase revenues by \$13,272,000 or 46.16% in the year 2006; 7,516,400 or 17.86% in the year 2007; and \$10,295,100 or 20.73% in the year 2008.

Application 05-02-012
(Filed February 28, 2005)

In the Matter of the Application of California-American Water Company (U 210 W) for Authorization to Increase its Rates for Water Service in its Felton District to increase revenues by \$796,400 or 105.2% in the year 2006; \$53,600 or 3.44% in the year 2007; and \$16,600 or 1.03% in the year 2008; and for an order authorizing two Special Requests.

Application 05-02-013
(Filed February 28, 2005)

**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES
ON THE PROPOSED DECISION**

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Application 05-02-013
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**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES
ON THE PROPOSED DECISION**

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure, the Division of Ratepayer Advocates ("DRA") files its Comments on the Proposed Decision of Administrative Law Judge ("ALJ") Walwyn.

In addition to addressing the legal, technical, and factual errors, DRA's comments also address its concerns with the Draft Proposed Decision process used in this case. As discussed below, the process employed by the Commission to move from the draft proposed decision to the revised proposed decision raises the appearance of impropriety and works to circumvent rules specifically designed to ensure that decisions are justified and based upon the record. The result raises serious issues of undue influence and bias.

DRA's comments should not be construed to indicate that it does not support the adoption of the three settlements it reached with Cal Am. DRA has and continues to support Commission adoption of these settlements, including the Felton Settlement.

I. SUMMARY OF ERRORS

- The Proposed Decision errs by departing from past Commission decisions that find that water memorandum accounts should earn interest at the 90-day commercial paper rate and instead finding, without justification, that the San Clemente Dam project should earn AFDUC in the manner prescribed for energy utilities adopting a formula used for nuclear ratemaking.
- The Proposed Decision errs in ordering all ESA compliance costs related to the San Clemente Dam, including those costs already embedded in rates, to be booked to the San Clemente Dam memorandum account.
- The Proposed Decision errs in allowing routine environmental compliance operating expenses to earn AFDUC.
- The Proposed Decision errs by transferring the plant decision-making process from Cal Am to the Commission by finding that because the Commission did not express concern that Cal Am had

not abandoned the Carmel River Dam project, Cal Am management had acted reasonably.

- The Proposed Decision errs in finding that there were no alternatives available at the time of the Carmel River Dam project. The record contains evidence of alternatives.
- The Proposed Decision errs in concluding that Cal Am management acted reasonably in pursuing the Carmel River Dam project.
- The Proposed Decision errs when it states that it will rely on principles of past Commission decisions finding that “at all time the shareholder will bear some of the risks of abandoned projects” and that the “utility should bear a major part of the risk” to provide proper management incentive, and then allocating all costs to ratepayers, and allowing shareholders to actually profit on the abandoned project.
- The two decisions the Proposed Decision cites to to support the order to allow Carmel River Dam costs to earn interest at the 90-day commercial paper rate provide no such support. One decision involves a net gain to ratepayers and the other involves a settlement that cannot be used as precedent.
- The Proposed Decision errs in adopting a rate design that is untested and has no basis in the record.
- The Proposed Decision errs by adopting a tariff for Cal Am’s after-hours connection fee that does not comply with the Monterey Settlement Agreement.

II. BACKGROUND OF PROPOSED DECISION PROCESS

On August 16, 2006, ALJ Walwyn issued a Draft Proposed Decision in this proceeding (“August 16th Draft PD”).¹ With the Draft Proposed Decision, ALJ

¹ The issuance of a Draft Proposed Decision is a relatively new process by which the ALJ seeks

Walwyn issued a ruling requiring Cal Am and DRA to provide assistance to the Commission's Water Division in preparing the figures and appendices needed to complete the Draft Proposed Decision. (August 16, 2006 Ruling of ALJ Walwyn.) The Ruling permitted, but did not require, other parties to participate in the process to the extent the Water Division finds their participation helpful. (*Id.*) As far as DRA is aware, no other party participated in the process or assisted the Water Division.

The August 16th Draft Proposed Decision, rejected the Monterey, Felton and General Office settlements reached between Cal Am and DRA. For the Monterey District, the August 16th Draft PD found the provisions of the Monterey Settlement that addressed the proposed capital structure, the cost of debt, the amount allocated for meter replacements, and the discontinuance of recording merger savings to be unreasonable. (Aug. 16th Draft PD, p. 2.) The August 16th Draft PD allowed recovery of Carmel River Dam expenses, without interest, over six-years, moved all San Clemente Dam retrofit costs to a memorandum account that earned interest at the 90-day commercial paper rate, adopted a memorandum account for Endangered Species Act ("ESA") and State Water Resources Control Board ("SWRCB") compliance costs but not for fines, and retained the existing rate design with some modifications. (*Id.* at p. 3)

For the Felton District, the August 16th Draft PD found the portions of the Felton settlement that addressed the amount authorized for the Highway 9 project and general and administrative expenses to be unreasonable and made an adjustment for lobbying activities in the Felton district. (*Id.* at p. 2). The August 16th Draft PD retained the existing rate design, adopted DRA's proposal for a low-income program, adopted a rate increase cap of 50 percent, and established a process to oversee future plant investment in the Felton district.

help in preparing the Proposed Decision. DRA has only seen this process used in water proceedings and can only recollect two previous instances of its use. There are no specific rules in the Commission's Rules of Practice and Procedure that apply to Draft Proposed Decisions.

For General Office expenses, the August 16th Draft PD made several downward adjustments to the settlement amounts allocated to Monterey and Felton and required Cal Am to make a showing in future rate cases when total expense increases are higher than inflation. (*Id.* at p. 2.) The August 16th Draft PD also required the tracking and monitoring of certain customer service costs and required justification for certain expense items. (*Id.* at p. 3.)

On September 13th and 14th, representatives from Cal Am held three separate ex parte meetings regarding the August 16th Draft PD. In the first meeting, Cal Am representatives met for approximately sixty minutes with Commissioner Bohn's Chief of Staff, Robert Lane and Advisor Laura Krannawitter. At this meeting, Cal Am's representatives urged Commissioner Bohn's office to adopt the Settlement Agreements unchanged, particularly the portions dealing with rate of return and general office. The Cal Am representatives urged Bohn's office to adopt Cal Am's requests regarding the San Clemente Dam, to authorize the memorandum accounts for ESA and SWRCB fines, to implement Cal Am's proposed rate design for both Felton and Monterey, to find that Cal Am has demonstrated synergy savings from the acquisition of Citizens Utilities, and to reject the imposition of a 50 percent cap on rate increases for the Felton District.

Cal Am representatives next met with President Peevey's Advisor Rami Kahlon for approximately thirty minutes. Cal Am representatives urged President Peevey's office to adopt the Settlement Agreements unchanged.

On September 14, 2006, Cal Am representatives met with Commissioner Chong's Advisor, Timothy Sullivan for approximately thirty minutes. Cal Am representatives again urged the Commissioner to adopt the Settlements unchanged, sought rate recovery of San Clemente Dam costs, requested a memorandum account for ESA and SWRCB fines and asked for a finding that Cal Am has demonstrated synergy savings from the acquisition of Citizens Utilities.

On September 26, 2006, Cal Am filed a late notice of these ex parte meetings claiming that it had wrongfully believed that it was not required to report these meetings under the new ex parte rules that became effective September 13, 2006.

On September 26, 2006, Commissioner Bohn's Advisor, Ms. Krannawitter called Cal Am to alert Cal Am that major changes were being made to the August 16th Draft PD and that there would be a five day turn around time to prepare figures and appendices to reflect these major changes. (See Cal Am's September 29, 2006, Ex Parte Notice.)

On September 27, 2006, a Revised Draft Proposed Decision was issued. This Revised Draft Proposed Decision contained substantial changes from the August 16th Draft PD. Some of the most significant changes include:

- Unlike the August 16th Draft PD, the Revised Draft PD adopts the Monterey and General Office Settlements, unchanged.
- The Revised Draft PD allows Cal Am to accrue AFDUC on San Clemente Dam costs as prescribed under the USOA for energy utilities rather than at the 90 day commercial paper rate as ordered in the August 16th Draft PD.
- While both the August 16th Draft PD and the Revised Draft PD allow Cal Am to recover costs of the abandoned Carmel River Dam project from ratepayers, the Revised PD allows Cal Am to earn interest on these costs at the 90-day commercial paper rate and recover the costs over a four year period while the August 16th PD found that Cal Am should not earn interest on these costs while being recovered over the next six year because it had already earned almost \$1 million on this abandoned project.
- The Revised Draft PD removed the requirement that the 2009 General Office Audit proposed by Cal Am and DRA be expanded to

include a full review of the methodology used to allocate the Citizen's acquisition premium.

On October 6, 2006, ALJ Walwyn issued the Proposed Decision. Except for the addition of the attached tables and tariffs, the PD was essentially the same as the September 27, 2006 Revised Draft PD.

III. DRAFT PROPOSED DECISION PROCESS RAISES THE APPEARANCE OF IMPROPRIETY

As discussed in footnote 1 above, the issuance of a Draft Proposed Decision is a relatively new process that some ALJs are using to assist them in preparing their Proposed Decision. DRA has only seen this process used in water proceedings and can only recollect two previous instances of its use. There are no specific rules in the Commission's Rules of Practice and Procedure that apply to Draft Proposed Decisions.

DRA opposes the use of the draft proposed decision process when it allows substantive changes to be made to the draft proposed decision based on lobbying efforts and when it fails to provide justification for the changes between the various versions of the draft PDs. In this case, significant differences arose between the August 16th Draft PD and the October 6th Proposed Decision. The Proposed Decision does not contain any discussion on why positions presented in the August 16th Draft PD were changed to the positions adopted in the Proposed Decision. It appears that these changes were made as a result of lobbying efforts by Cal Am. If this is the case, it brings the integrity of the Commission's decision-making process in this case into question.

The Draft Proposed Decision process appears to allow the Commission to circumvent its own rules through loopholes and technicalities. While DRA fully supports the Commission adoption of the Cal Am / DRA settlements, DRA is concerned that the method by which the settlements are ultimately approved raises the appearance of impropriety.

While DRA is aware that it along with Cal Am had numerous opportunities to present its position and recommendations on the proposed decision of ALJ Walwyn, the process of transforming the draft proposed decision into something the Commission will place on the agenda for a formal vote has been less than transparent.

In the past, the Commission's Water Division has been responsible for deriving the final numbers in a decision based on the judgments that have been made by the ALJ.² This process has now been modified so that it has become the responsibility of DRA and the water utility to agree on a set of numbers based on the initial judgments made by the ALJ. However, the draft proposed decision proffered no guidance about how this process was to occur. Instead of a straightforward meeting of the minds between DRA and Cal Am, lobbying and ex parte contacts with various members of the Commission staff became the *de facto deux ex machina* for rendering a final decision in this proceeding. Not only does this process raise the likelihood of unequal access and one-sided representations to the ultimate decision-makers, it is anything but transparent. Moreover, allowing for this type of lobbying necessarily diminishes the evidentiary nexus between the record in this case and the ultimate decision. It is incumbent on the Commission to develop a decision making process that is not only fair, but equally accessible and transparent to all participants.

Under the Judicial Canon of ethics, judges have a responsibility to exercise reasonable care to avoid the appearance of impropriety. Towards that end, the process the Commission will use to settle on final numbers (between the issuance of a draft proposed decision sans numbers) and the Commission's final

² In energy cases, no draft proposed decision is issued by the ALJ. Instead the ALJ and/or the Assigned Commissioner ask for assistance from the utility and DRA to run the RO models to develop the revenue requirement. The parties who participate in this process sign a non-disclosure agreement and no text of the PD is provided to the parties helping to run the numbers to generate the RO tables.

vote on the case needs to be as respectful of due process requirements as the hearing process itself.

The draft proposed decision process as used in this case raises the appearance of impropriety and works to circumvent rules specifically designed to ensure that decisions are justified and based upon the record. Had the Water Division been able to generate the rate tables, the ALJ would have likely issued the August 16th Draft PD as the PD and an alternate may have been developed and released simultaneously, thereby giving the Commissioners the opportunity to hear and comment on both. Because the first August 16th Draft PD had no numbers, it makes it impossible for all parties to evaluate the impact of what has happened between August 16th Draft PD and the October 6th PD.

Unfortunately, the process employed by the Commission to move from the draft proposed decision to the revised proposed decision appears to have employed a less than assiduous effort to ensure that all affected parties had equal access to decision-makers. The result raises serious issues of undue influence and bias because of Cal Am's apparent close collaboration with Commission decision-makers.

IV. SAN CLEMENTE DAM

A. It is legal error for San Clemente Dam retrofit costs to earn interest at the rate prescribed under the USOA for energy utilities.

DRA agrees with the Proposed Decision's determination that the San Clemente Dam retrofit project is still uncertain and the dam's usefulness is unclear and that Cal Am should book all retrofit costs to a memorandum account until the project and dam's usefulness becomes certain. DRA disagrees, however, with the PD's conclusion that costs booked to this account should earn interest at the Allowance for Funds Used During Construction ("AFDUC") rate prescribed under the Uniform System of Accounts ("USOA") for Energy Utilities. This conclusion is a legal error because 1) it fails to justify why departure from prior Commission

decisions is appropriate, and 2) it fails to address why the Commission should employ the USOA relied on for energy utilities for water utilities or why it should be used for this project.

In 1994 the Commission opened an investigation into the financial and operational risks of Commission regulated Water Utilities (I.90-11-033). As a result of that proceeding, the Commission issued D.94-06-033 authorizing all water companies subject to the Commission's jurisdiction to earn interest at the 90-day commercial paper rate on balancing account and memorandum account (except drought and conservation memorandum accounts) postings that occurred on or after the date of the decision. (*Re Financial and Operational Risks of Commission-regulated Water Utilities*, (D.94-06-033) 55 CPUC 2d 158, 194-195.)

The Proposed Decision departs from D.94-06-033 and instead authorizes Cal Am to earn AFDUC on the costs booked to the memorandum account via the formula prescribed in the USOA for Energy Utilities. The PD states that "for energy projects, the Commission generally uses an AFDUC interest rate that also reflects long-term debt and equity" and that such a formula is appropriate for the San Clemente Dam. (PD, p. 45.) However, the Proposed Decision does not provide any justification for departing from the conclusion of D.94-06-033 that memorandum accounts for the water industry should earn interest at the 90-day commercial paper rate or why it is appropriate to use the energy utilities' USOA for Cal Am or for this particular project.

B. Nuclear Ratemaking Has No Place in the Water Industry

The formula the Proposed Decision adopts to calculate AFDUC is clearly inappropriate for water utilities as it takes into account such items as "nuclear fuel in process of refinement, conversion, enrichment and fabrication." (PD, p. 46) The instructions for calculating the rate states that "the cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in § 35.13 of the Commission's Regulations under the Federal

Power Act.” Again, the Proposed Decision does not state what these instructions are or why Regulations under the Federal Power Act are appropriate for water utilities, or the San Clemente Dam retrofit project.

DRA notes that the August 16th Draft PD came to a different conclusion regarding the interest Cal Am should earn on the San Clemente Dam memorandum account. The August 16th Draft PD found that Cal Am should only accrue interest on the San Clemente Dam costs at the 90-day commercial paper rate.

Although both the PD and the August 16th Draft PD state that the ratemaking treatment used for the San Clemente Dam project is consistent with the policy the Commission articulated in D.03-09-022, only the August 16th Draft PD is, in fact, consistent. In D.03-09-022, the Commission placed the Coastal Water Project costs in a memorandum account earning interest at the 90-day commercial paper rate. The Commission found that the 90-day commercial paper rate was appropriate because the project was still uncertain. The decision also stated that ratemaking treatment for the project may change as it becomes more certain. (D.03-09-022, p. 23.) Similar to the Coastal Water Project, the San Clemente Dam retrofit project is still uncertain; thus, it is appropriate for Dam costs to earn interest at the 90-day commercial paper rate. This ratemaking treatment can be reevaluated when the project and dam’s usefulness become more apparent.

C. The final decision should contain an ordering paragraph on the San Clemente Dam

Although the August 16th Draft PD includes an ordering paragraph on the San Clemente Dam stating that “retrofit project costs shall be removed from rate base and placed in a memorandum account for later reasonableness review” there is no similar ordering paragraph, or in fact any ordering paragraph, addressing the San Clement Dam project in the Proposed Decision. An Ordering Paragraph similar to Ordering Paragraph 8 of the August 16th Draft PD must be added to the

Proposed Decision to assure that all retrofit project costs are removed from rate base and placed into this memorandum account.

D. Only ESA compliance costs that are not already included in rates should be booked to a memorandum account earning interest at the 90-day commercial paper rate.

The Proposed Decision finds that all ESA compliance costs related to the San Clemente Dam project be booked to the San Clemente Dam memorandum account and earn interest at the AFDUC rate prescribed under the USOA for Energy Utilities. Requiring all ESA compliance costs, including those already embedded in rates and those that are regularly expensed to earn interest at the AFDUC rate prescribed under the Uniform System of Accounts for Energy Utilities is legal and factual error.

DRA agrees that ESA compliance costs related to the San Clemente Dam, which are not already embedded in rates should be booked to a memorandum account for later review. However, it is legal error to allow Cal Am to book costs that are already in rates to this memorandum account. Moreover, it is error to allow Cal Am to earn AFDUC on ESA compliance costs that would typically be considered operating expenses, such as the costs of surveys, monitoring, predator detection and removal, personnel training, and fish trap and truck. (See MPWMD Opening Brief, p. 19.) Routine environmental compliance operating expenses should never be treated as a form of plant.

The Commission should modify the Proposed Decision to assure that only ESA compliance costs relating to the San Clemente Dam that are not already embedded in rates are booked to the memorandum account and that ESA compliance costs earn interest at the 90-day commercial paper rate as required under D.94-06-033. (*Re Financial and Operational Risks of Commission-regulated Water Utilities*, (D.94-06-033) 55 CPUC 2d 158, 194-195.)

V. CARMEL RIVER DAM

The Proposed Decision relies on incorrect information to find that Cal Am acted reasonably in pursuing the Carmel River Dam. Even assuming *arguendo* that Cal Am management did act reasonably, the Proposed Decision contains factual and legal error because contrary to established Commission practice it fails to have the Cal Am bear any risk of the abandoned Carmel River Dam project. Although acknowledging that shareholder should bear a major part of the risk of abandoned projects, as discussed below the Proposed Decision allows shareholders to profit from the abandoned Carmel River Dam project.

A. Cal Am did not demonstrate that it exercised reasonable management skill in identifying, evaluating, and reevaluating the risks of the Carmel River Dam project

Although it is long-standing Commission policy is to require shareholders to absorb the costs of abandoned projects, the Commission may find an exception to this policy and require ratepayers to share in the costs of an abandoned project where the project occurred during a time of great uncertainty and where the utility demonstrated that it exercised reasonable management.

To find that ratepayers should bear some of the costs incurred for a project which is ultimately canceled, the Commission looks to see if the utility exercised reasonable managerial skill by 1) identifying, assessing and quantifying the risks of the project, 2) analyzing the project and alternatives, and 3) reevaluating the project and its risks. (PD, p. 52-53, *citing Re Pacific Gas and Electric Company* (D.84-05-100) 15 CPUC 2d 123, 126.). Although agreeing that these are the criteria to use to determine whether ratepayers should share in the risk of abandoned projects, the Proposed Decision fails to properly apply these criteria to Cal Am's actions.

1. It is legal error to conclude that it was the Commission's responsibility and not Cal Am's management to determine whether continuation of the Carmel River Dam project was reasonable.

Although the Proposed Decision acknowledges that Cal-Am did not document any formal annual process to satisfy the third criteria to reevaluate the Carmel River Dam project, the Proposed Decision concludes that Cal Am acted reasonably because key agencies, including the Commission, supported Cal Am pursuing the project. (PD, p. 57). Specifically, the PD states that it looked at the language the Commission used in discussing this project in 2003 in D.03-02-030 and D.03-09-022 and found that neither of these decisions expressed concern that Cal Am had not abandoned the project. (*Id.*) The PD finds that this lack of expressed concern by the Commission supports Cal Am's position that actions through August 2003 were viewed as reasonable. (*Id.*)

The PD errs as this conclusion effectively transfers the plant decision-making process from Cal Am to the Commission. The Proposed Decision fails to recognize that it is Cal Am's management's responsibility and not the Commission, or any other agency, to determine whether or not a Cal Am project should continue forward. Utilities are compensated for this type of risk in their rate of return.

In addition to wrongfully shifting the burden of going forward with projects to the Commission, the Proposed Decision contains factual error when it indicates that the Commission did not express concerns about the project. The Proposed Decision looked solely at two 2003 decisions that were issued at or near the time the Carmel River Dam project was actually abandoned. However, in August 1998, in D 98-08-036 the Commission found that that Cal Am should have had a contingency plan for the Carmel River Dam project in case the project did not move forward to assure that compliance with Order 95-10 was not solely dependent on the dam. (*Re California-American Water Company*, (D.98-08-036.)

81 CPUC 2d 648, 656.) The Commission recognized that the dam could become infeasible for various reasons such as successful citizen opposition to the dam through the courts or at the polls. (*Id.* at p. 655.)

In D.98-08-036 the Commission, however, did not tell Cal Am whether it should proceed with the dam because it recognized that this was not the Commission's role. The Commission stated that it was making no prejudgments of the dam or alternatives as it was the Commission's absolute commitment to "candor and transparency in the decisionmaking process." (*Id.* at 655.) The Commission found that it is was Cal Am's responsibility and not the Commission's to take the lead in choosing its projects and formulated them. (*Id.*) It is legal error for the Proposed Decision to find that Cal Am acted reasonably because the Commission chose to act as it should during the course of the proceeding to certify the Carmel River Dam and remain impartial on the project,

DRA is extremely concerned that this holding may effectively transfer utility risk in future proceedings. For example, Cal Am presently has a CPCN application for the Coastal Water Project. If this project it is later abandoned for a regional project will Cal Am argue that because the Commission did not tell it to cease the project it must have acted reasonably? A comparable holding in this case will have great implications on future proceedings involving abandoned projects. It improperly substitutes the Commission's judgment for that of utility management to determine whether projects are reasonable.

2. It is legal and factual error to find no other alternatives existed to the Carmel River Dam project.

The Proposed Decision finds that Cal Am met the requirement that it identify and assess the risks of the Carmel River Dam project based on the false conclusion Cal Am had to proceed with the project because there were no other feasible alternatives and SWRCB Order 95-10 requires Cal Am to be actively

pursuing additional water supply. (PD, pp. 54-55) However the record does not support either of these conclusions.

First, the record demonstrates that other alternatives were available even before the voters rejected the New Los Padres Dam in November of 1995. In February 1996, before Cal Am filed its application with the Commission for the Carmel River Dam project, MPWMD adopted Resolution 96-02 directing district staff to focus on non-dam alternative such as water reclamation, water conservation, ground water development in the Seaside Basin, conjunctive use of waters in the Carmel River Basin, and desalination. (Exhibit 88/ORR, pp. 14-19.) Cal Am could have done the same.

Instead, Cal Am chose to pursue the Carmel River Dam. The Commission should not reward Cal Am's for failing to identify or pursue alternatives when the reason no alternatives were identified or pursued was because Cal Am chose not to do so. Such a finding goes against the intent of the requirement that it is the utility management's responsibility to evaluate alternatives, which existed as MPWMD was pursuing them.

The PD also finds that Cal Am's claim that it had to continue with the project until it was certain there was a viable alternative shows reasonable management behavior because Cal Am had to work with the SWRCB order to avoid enforcement action. (PD, p. 55.) Nothing in SWRCB Order 95-10 required Cal Am to pursue a project that had no chance of completion. Moreover, continuing to pursue a project that had little to no likelihood of completion due to environmental issues and public opposition cannot be considered diligently pursuing a new water supply. It is factual error to find that Cal Am was diligently pursuing a new water supply once it was clear that there was no chance of the dam actually being built.

B. Cal Am's shareholders must bear part of the risk of the abandoned Carmel River Dam project.

If the Commission finds that the utility undertook a project during times of great uncertainty and that utility management acted reasonably, ratepayers and shareholders are supposed to share in the abandoned project costs.

As the PD discusses, even if a utility shows that its management acted reasonably when it went forward with a project that was later abandoned, the shareholders still bear part of the costs of the project. As the Commission has previously stated and as the Proposed Decision recognizes:

[T]he ratepayer does not become the utility's underwriter in a period of high risk. At all times, the shareholder will bear some of the risks of abandoned projects. The utility should bear a major part of the risk in order to provide proper management incentives. (Proposed Decision p. 53, *citing Re Pacific Gas and Electric Company*, (1984) 15 CPUC 2d 123, 125 (D.84-05-100) emphasis added.)

The Proposed Decision, however, fails to have Cal Am's shareholders bear any risk of the project.

Shareholders are compensated for risks of abandoned projects in the utilities' rate of return. (*Re SoCal Gas Co.*, (D.92497) 4 CPUC 2d 725, 781.) Yet Cal Am shareholders have earned \$933,000 on the abandoned Carmel River Dam project because the Commission had previously allowed project costs in CWIP in rate base. The Proposed Decision now finds that ratepayers must pay 100 percent of the direct costs of the project. Furthermore, the Proposed Decision makes ratepayers pay the shareholders interest on these costs at the 90-day commercial paper rate until they are returned.

Not only are Cal Am shareholders not sharing in the risk of this project, they will, in fact, profit from this project. Although the direct costs of the project amounted to \$3,290,103³ under the PD, Cal Am shareholders will end up being

³ \$3,646,542 - \$356,549 AFDUC = \$3,290,103.

compensated \$4,534,200⁴ for the project. Cal Am shareholders are not out a dime for the money they have invested on the project. However, if the proposed decision is adopted as written, Cal Am's ratepayers will have paid over \$4.5 million for an infeasible, now abandoned project. The Commission will have been remiss in its duty to protect Cal Am's ratepayers if the decision goes forward as written.

As discussed above, the record demonstrates that Cal Am had not acted reasonably in pursuing the Carmel River Dam project thus the shareholders should be required to bear the costs of the abandoned project. However, even assuming that Cal Am management had acted reasonable, shareholders must still be allocated "a major part of the risk of the project" and thus a significant share of the costs. The Commission must allocate a significant share of the costs to shareholders.⁵ At a minimum, the Commission should reduce the amount allocated to ratepayers by the \$933,000, the amount Cal Am shareholders have already been compensated and should not require Cal Am shareholders to earn any additional interest on the costs.

C. Citing to D.84-05-100 to support allowing Cal Am to earn interest at the 90-day commercial paper rate is legal error.

The Proposed Decision cites to D.84-05-100 to support its decision to allow Cal Am to earn interest on the abandoned Carmel River Dam costs at the 90-day commercial paper rate. The Proposed Decisions states that in that case, the abandoned projects were placed in PG&E's ERAM account, which earns interest at the 90-day commercial paper rate. (PD at p. 59.) However, there is nothing in D.84-05-100 that states that PG&E would be permitted to earn interest on these funds.

⁴ $\$933,000 + (\$900,300 \times 4\text{yrs}) = \$4,543,200$. (\$900,300 figure from Appendix 1, p. 2)

⁵ In D.92497 the Commission allocated 74.22 percent of the abandoned project costs to ratepayers and 25.78 percent to shareholders. This was after removing AFDUC. *Re SoCal Gas Co.*, (D.92497) 4 CPUC 2d 725, 830.

The decision states that the ratepayers' participation in sharing of abandoned project costs should be limited to "the direct costs" of the abandoned project. (*Re Pacific Gas and Electric Company*, 15 CPUC 2d 123, 127.) While the Commission ordered \$11.8 million of abandoned project costs to be booked to the ERAM account, those costs were more than offset by the \$19.3 million in gains that the Commission also allocated to the ERAM account that were associated with one of the abandoned projects. (*Id.* at pp. 128, 130.)

In the past decisions when the Commission has found that ratepayers should only bear the direct costs of a project, those direct costs do not necessarily include interest on the amortized costs. In *re Southern California Edison Company*, the Commission adopted a proposal set forth by parties in a motion to allow SCE to recover costs associated abandoned project. Under that proposal, cost recovery for the abandoned project was to be accomplished by an adjustment to SCE's ERAM balancing account. The proposal, which was adopted by the Commission, provided that "in accordance with the Commission's ratemaking treatment of abandoned project expenses, the amount would be recovered by debiting the ERAM balancing account \$2.235 million per year over a three year period with no interest allowed during the amortization period." (*Re Southern California Edison*, (D.97-05-081) 72 CPUC 2d 552, 556, emphasis added.).

Thus, the decision cited by the PD does not support the recommendation to allow Cal Am to earn interest on abandoned project costs during the amortization period.

D. It is legal error to rely on settlement agreements as precedent.

The Proposed Decision tries to support its decision to allow Cal Am to earn interest on the costs of the abandoned Carmel River Dam project at the 90-day commercial paper rate by citing to a settlement adopted by the Commission in D.00-06-054. However, as Rule 12.5 of the Commission's Rules of Practice and Procedure clearly states, unless the Commission expressly provides otherwise,

adoption of the settlement does not constitute precedent regarding any principle or issue in the proceeding or in any future proceeding. In D.00-06-054, the Commission did not state any intent to make any principle or issue in the settlement precedential. Moreover, in adopting the settlement, the Commission adopted the provision of the settlement specifically stating that the settlement agreement is not precedential in any other proceeding before the Commission. (*Re Kramer-Victor Project*, (D.00-06-054) 6 CPUC 3d 568, 574.)

In addition, the facts of that settlement show that while SCE was allowed to earn interest on the costs of the abandoned Kramer-Victor project, SCE agreed to reduce the amount of costs it was allowed to recover from approximately \$10.9 million to \$8.8 million and to credit ratepayers half of any amounts that SCE received from the Luz International Limited bankruptcy proceeding. Thus, in exchange for allowing interest on the costs, SCE shareholder were allocated at least \$2.1 million in abandoned project cost and thus shared in the risk of the abandoned project.

It is legal error for the Commission to rely on the settlement adopted in D.00-06-054 to support a decision to allow Cal Am to earn interest at the 90-day commercial paper rate on the costs of the abandoned Carmel River Dam project.

VI. THERE IS NO EVIDENCE IN THE RECORD TO SUPPORT THE ADOPTED RATE DESIGN

The Proposed Decision retains the existing rate design for Monterey with one modification – it eliminates the per capita allocation in the third through fifth blocks. The Proposed Decision states that it makes this modification “to promote more conservation of outdoor water use.” (PD, p. 104, Finding of Fact 30.)

While DRA agrees that there should be more incentives to conserve water used for large landscapes, there is no evidence in the record that elimination of the per capita allocations in the third through fifth blocks will accomplish this stated

purpose without unintended consequences on large families.⁶ Neither Cal Am nor DRA have analyzed the impacts of this new rate design as it was not proposed by any party, and was not part of the Record.

Moreover, the PD does not reflect any changes in consumption patterns as a result of this new rate design. While it may reduce consumption in the third to fifth tiers, under this rate structure every customer will pay the same or more than under the existing rate structure. The PD has no discussion, analysis, or decision concerning what the rate differentials between the blocks should be, so the rate tables use the same rates as the existing rate design while changing the allocation in the upper tiers.

The current per capita rate design already produces approximately a half a million dollars per year more than necessary. Depending on how consumption is affected, it is possible that further over collections may occur as a result of this change. Although over collections would eventually be refunded, the Commission should not require Cal Am to make changes to the rate design that have not been thoroughly evaluated. Ratepayers understand the current system. Making a change will involve some cost and require re-educating customers. Implementing a change that may require ratepayers to pay more than necessary and that will likely have to be changed again in three years is not prudent.

DRA recommends that the Commission retain Cal Am's existing rate design but review this issue again in Cal Am's next GRC while reiterating its interest in adopting a rate structure that minimizes outdoor water usage.

VII. FACTUAL ERRORS

DRA noted a number of factual errors contained in the Proposed Decision. DRA recommends the following changes to correct these factual errors:

⁶ Removing the water allocations based on lot size as described in Attachment 1, p. 7 appears more likely to promote water conservation of outdoor water use.

- References to D.03-09-002 throughout the Proposed Decision, should be changed to D.03-09-022.
- An Ordering Paragraph should be added to the Proposed Decision adopting the Monterey and General Office Settlements.
- Footnote 15 states that the Commission's revised Rules of Practice and Procedures became effective on September 15, 2006. The Rules became effective on September 13, 2006. (See Commission Website at <http://www.cpuc.ca.gov/static/documents/codelawspolicies.htm>)
- On page 58, the Proposed Decision states that it finds that \$3,646,542 of Carmel River Dam costs should be recovered from ratepayers. If the Commission does not change the decision to require Cal Am shareholders to share in the risks of the project, this figure must still be reduced to \$3,290,103 to reflect the order to remove all AFDUC from the project. (See OP 8.) DRA notes that the tables in Attachment A already reflect this change.
- The August 16th Draft PD contained Ordering Paragraph 8 which stated: "The San Clemente Dam retrofit project costs shall be removed from rate base and placed in a memorandum account for later reasonableness review." The PD contains no ordering paragraph regarding the San Clemente Dam. Ordering Paragraph 8 of the August 16th Draft PD should be added back to the Final Decision.
- Page 30 in Attachment 1 contains a draft tariff for the new rule covering the fee for after-hours restoration of service. The tariff states that "Customers who face the fee and reside in the area the PAR program is offered will be notified of the PAR program at the time the reconnection is made." The Cal Am /DRA Settlement on this issue requires that notice be provided to the customers at the

time the request for reconnection is made, not when the reconnection is actually made, thus providing a qualifying PAR customer to sign up for service and avoid the \$50 reconnection fee. (See Monterey District Settlement 4.14(k).) The tariff language must be changed to properly reflect the Settlement Agreement.

- Although just a clarification change, DRA recommends that the Commission add to the introduction of the Decision the percentage rate increases authorized for both the Monterey and Felton Districts.

VIII. OTHER ISSUES

The Proposed Decision adopts the Cal Am / DRA settlement of \$37,200 for meter replacement expenses. The PD, however, asks Cal Am and DRA to further consider MPWMD's recommendation to increase meter replacement expenses to \$120,000 for the three year GRC cycle. DRA has reviewed this request but does not agree to modify the settlement to increase meter replacement expenses to \$120,000. As Cal Am states, and the PD cites, a more aggressive meter replacement plan will not necessarily reduce unaccounted for water. (PD, p. 21.) DRA will review this issue again in the next GRC.

In the area of synergy savings and allocation of the acquisition premium, the Proposed Decision requires Cal Am to file supporting documentation for the amortization amounts of the acquisition premium allocated to Monterey and Felton. It is unclear to DRA the intent of this requirement, as the Proposed Decision does not require anyone to review these documents to assure that they support the position adopted in the Decision. DRA recommends that the final decision clarify who will review these documents to assure they provide the required information.

Finally, DRA continues to recommend that the Commission adopt the Felton settlement. The settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

IX. CONCLUSION

DRA recommends that the Commission modify the Proposed Decision as discussed above. Unfortunately the Proposed Decision contains numerous factual and legal errors that require correction. As written, the Proposed Decision contains far too many legal and factual errors to withstand either internal or appellate scrutiny.

Respectfully submitted,

/s/ MONICA MCCRARY

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October 26, 2006

ATTACHMENT A

CHANGES TO FINDINGS OF FACT AND CONCLUSIONS OF LAW⁷

Findings of Fact

16. Establishment of a memorandum account to track compliance with ESA requirements is reasonable. ESA compliance costs associated with the San Clemente Dam retrofit but not already embedded in rates should be tracked in a separate memorandum account with all other San Clemente Dam retrofit costs.

24. The San Clemente Dam retrofit is a lengthy and uncertain project. All costs related to the project, including ESA compliance costs not already embedded in rates, should be tracked in a memorandum account until the Commission has the opportunity to fully review the completed project for reasonableness. The memorandum account should have a cost cap of \$9,379,525 for 2004, \$1,321,590 for 2005, \$1,863,825 for 2006, and \$11,433,000 for 2007 and accrue interest at the 90-day commercial paper rate. ~~Allowance for Funds Used During Construction (AFUDC) rate prescribed under our USOA for energy utilities.~~

27. Cal Am failed to identify, evaluate, and reevaluate the risks of the Carmel River Dam Project. Cal Am did not document any formal annual review process regarding the dam. Public opposition and environmental issues made pursuing the project unreasonable. Continuing with a project that had little if any likelihood of completion does not meet ~~Based on the requirement of Order 95-10 for Cal-Am to always be actively pursuing a water supply project, the initial cost effectiveness of the project, the environmental approvals through 1999, and the support of key public agencies for its actions, we find Cal-Am acted reasonably in initially~~

⁷ Additions are underlined and text that should be deleted is shown with ~~striketrough~~.

~~pursuing the Carmel River Dam project and then in waiting until it had approval for an alternative project, the Coastal Water Project, to cancel the project.~~

30. We should retain the existing rate design for Monterey. ~~with one modification: in residential rates for main system customers we eliminate the per-capita allocation in the third through fifth blocks to promote more conservation of outdoor water use.~~

Conclusion of Law

3. Consistent with the treatment we authorized for Cal-Am's Coastal Water Project in D.03-09-002, the San Clemente Dam retrofit project costs should be removed from ratebase and placed in a memorandum account for later reasonableness review. Consistent with D.03-09-022 and D.94-06-033, the memorandum account shall earn interest at the 90-day commercial paper rate. ~~The memo account should accrue AFUDC in the manner prescribed under our USOA for energy utilities.~~

4. Cal-Am has not shown that the Carmel River Dam is an abandoned project eligible to be considered for rate recovery under the standards established in D.84-05-100, and later cited by the Commission in D.89-12-057 and D.96-09-039.

5. Because Cal Am has not demonstrated that it acted reasonably in pursuing the Carmel River Dam project, shareholders bear the risk of the abandoned project. Cal-Am should remove the Carmel River Dam project from ratebase; and remove all AFUDC interest accrued prior to the project being placed in ratebase; ~~and place the balance in a separate account that should earn interest at the 90 day commercial paper rate and be amortized over four years as a meter surcharge.~~

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON THE PROPOSED DECISION** in **R.05-02-012 et al.** by using the following service:

☒ **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

☐ **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on October 26, 2006 at San Francisco, California.

/s/ ALBERT HILL
Albert Hill

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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